January 2020

PENSION ANALYST

Important information—Plan administration and operation

Year-end spending bill includes SECURE and other retirement provisions

Who's affected

This information applies to sponsors of and participants in qualified defined benefit and defined contribution plans, including 403(b) plans and 457 plans.

Background and summary

On December 20, 2019, President Trump signed into law a year-end spending bill, known as the Further Consolidated Appropriations Act of 2020 (the Act). This Act included provisions of the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which is a comprehensive retirement package intended to expand and preserve retirement savings. Among other key provisions, the new law:

- Allows unrelated employers to participate in multiple employer defined contribution plans ("open MEPs" or "pooled employer plans");
- Increases the qualified automatic contribution arrangement limit from 10% to 15% in the second year after the employee is automatically enrolled;
- Provides a new fiduciary safe harbor for annuity provider selections;
- Allows qualified plan participants to take a distribution of a lifetime income investment under certain situations without regard to the restrictions on plan withdrawals prior to a distributable event;
- Requires defined contribution plan benefit statements to include a lifetime income disclosure at least annually;
- Increases the age for required minimum distributions from 70½ to 72;
- Requires employers maintaining a 401(k) plan to cover long-term part-time workers who work at least 500 hours of service for three consecutive years;
- Permits penalty-free withdrawals from retirements plan for individuals in case of a birth or adoption of a child; and
- Removes "stretch" required minimum distribution provisions, except for eligible designated beneficiaries.

A separate tax package was included in the Act which addresses a number of expiring tax provisions, including special disaster-related relief for use of retirement funds for certain disasters occurring during the period beginning on January 1, 2018, and ending on February 18, 2020. The disaster-related relief provisions also provide for an automatic 60-day filing extension for disasters declared after December 20, 2019.

Additionally, the Act included a provision to reduce the minimum age for allowable in-service distributions for pension plans, such as defined benefit plans and money purchase pension plans, and governmental 457(b) plans from age 62 and 70½ respectively to age 59½. This change applies to plan years beginning after December 31, 2019.

Action and next steps

Plan sponsors should review the information in this publication to determine potential impacts to their plans. Since many of these provisions are effective on January 1, 2020 for calendar year plans, just days after the new law was enacted, industry groups have requested immediate guidance and relief from the Department of Treasury and the IRS. Prudential Retirement will keep you informed as any relief and additional guidance is issued.

RSMH080

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Related document
Key retirement plan provisions in year-end spending package

Provisions effective retroactively, immediately, or for plan years beginning after December 31, 2019

Increase in qualified automatic contribution arrangement (QACA) limit to 15 percent

A QACA is a 401(k) or 403(b) automatic enrollment arrangement that is not subject to ADP Testing, ACP Testing, or Top-Heavy Testing. To be a QACA, an automatic contribution arrangement must provide a specified schedule of automatic contributions, an employer contribution, and notices to participants describing the plan provisions. A QACA must provide for deferral contributions to be made automatically at specified percentages of compensation, unless a participant specifically elects not to participate or elects a different deferral rate. The minimum required deferral amount increases following a participant's initial period of participation (automatic escalation), but automatic deferrals may never exceed 10% of compensation.

The SECURE Act maintains the 10% limit for the first year in which the employee is automatically enrolled, but increases the limit to 15% after the first plan year. This provision is effective for plan years beginning after December 31, 2019.

Safe harbor 401(k) status

Under the SECURE Act, 401(k) or 403(b) plans that are either traditional safe harbor or QACA plans will no longer be required to provide a notice to participants and beneficiaries if the plan uses a nonelective contribution to satisfy the safe harbor. Safe harbor plans that use matching contributions to satisfy the safe harbor contribution rules must continue to provide notices to participants and beneficiaries.

The Act allows a plan to be amended to become a nonelective safe harbor plan for a plan year if the amendment is made before the 30th day before the close of the plan year. An amendment made after the 30th day before the plan year close is still allowed, but only if the amendment provides for a non-elective contribution of at least 4% of compensation for all eligible employees and the plan is amended no later than the last day for distributing excess contributions for the plan year. This provision is effective for plan years beginning after December 31, 2019.

Lifetime income portability

Under the Act, qualified plan participants may take a distribution of lifetime income investments without regard to the restrictions on plan withdrawals prior to a distributable event. The distribution would be allowed only if:

- The lifetime income investment is no longer authorized to be held under the plan, and
- Distribution is made as a direct trustee-to-trustee transfer to an IRA or other retirement plan or in the form of an annuity directly to the participant.

This provision is effective for plan years beginning after December 31, 2019.

Increase in required minimum distribution (RMD) age to 72

The Act increases the age for determining the required beginning date for RMDs for participants and beneficiaries in retirement plans and IRAs from age 70½ to age 72. This provision is effective for distributions required to be made after December 31, 2019, with respect to individuals who attain age 70½ after December 31, 2019.

An IRA owner or plan participant (if retired) who attains age 70½ in 2019 will need to take an RMD for 2019 by April 1, 2020, and an RMD for 2020 by December 31, 2020, even though they may not attain age 72 until 2021. As of January 1, 2020, IRA owners or plan participants (if retired) who turn 70½ in 2020 will not be required to take an RMD distribution first when requesting a distribution or rollover; the RMD first rule will begin to apply to them in the year they turn 72. Participants who had been receiving RMDs in 2019 will be required to continue to receive RMDs.

"Stretch" RMDs

Upon the death of an IRA owner or defined contribution participant, designated beneficiaries are required to draw down account balances within 10 years (five years for non-designated beneficiaries) of the death of the participant. This requirement does not apply to an "eligible designated beneficiary." An "eligible designated beneficiary" is any designated beneficiary of the employee who is:

- The surviving spouse of the employee;
- A child who has not reached the age of majority (but the 10-year rule would apply as of the date the child attains the age of majority);
- Disabled;
- Chronically ill; or
- Not more than 10 years younger than the IRA owner or participants.

This provision applies for deaths after December 31, 2019 (December 31, 2021 for governmental plans and certain collectively bargained plans).

Fiduciary safe harbor for selection of annuity provider

The Act adds a safe harbor to ERISA for the selection of annuity providers. This safe harbor:

- Clarifies that fiduciaries are not required to review the appropriateness of a selection after the purchase of a contract for a participant or beneficiary;
- Allows defined contribution plan fiduciaries to rely on certain written representations from insurers regarding their status under state insurance law (e.g., licenses, compliance with reserve requirements); and

- Deems fiduciaries to have conducted a periodic review if they obtain certain written representations from the insurer on an annual basis. This protection doesn't apply if a fiduciary receives notice from the insurer of any change in the circumstances occurring after the earlier representations or the fiduciary otherwise becomes aware of facts that would cause the fiduciary to question such representations.

This provision is effective immediately.

Withdrawals for birth or adoption of a child

The Act allows participants to withdraw up to $5,000 penalty-free from an IRA, a defined contribution plan, including a 403(b) plan, or a governmental 457(b) plan due to the birth or adoption of a child. The qualified birth or adoption distribution shall not be treated as an eligible rollover distribution, and therefore is exempt from mandatory 20% withholding and the special tax notice (also known as the "402(f) notice"). These withdrawals are also exempt from the 10% early distribution tax penalty. The participant would be required to include certain information regarding the child on his or her tax return. The $5,000 limit applies in the aggregate to all plans of the employer (and any member of any controlled group which includes the employer) for the participant.

The distribution must occur within the one-year period beginning on the date on which a child of the individual is born or on which the legal adoption of the eligible adoptee is finalized. An eligible adoptee means any individual (other than a child of the taxpayer's spouse) who has not attained age 18 or is physically or mentally incapable of self-support. The withdrawal may be repaid as a rollover contribution. Repayment to an employer-sponsored retirement plan may not exceed the amount of the distribution made from the plan.

This provision applies to distributions made after December 31, 2019.

Treatment of custodial accounts on termination of section 403(b) plans

The Act directs the IRS to issue guidance within six months, providing that under which if an employer terminates a 403(b) custodial account, the plan administrator or custodian may distribute an individual custodial account in-kind to a participant or beneficiary. The custodial account shall be maintained on a tax-deferred basis until paid out, subject to the 403(b) rules in effect at the time the account is distributed.

The forthcoming guidance by the IRS will apply retroactively for taxable years beginning December 31, 2008.

Retirement income accounts for church employees

The Act clarifies that the following individuals or employees of certain church-related organizations may participate in 403(b)(9) retirement income accounts:

- Duly ordained, commissioned, or licensed ministers of a church regardless of the source of his or her compensation;
- Employees of a tax-exempt organization, whether a civil law corporation or otherwise, which is controlled by or associated with a church or a convention or association of churches, and:
- Employees included in the church plan who then separate from the service of a church or a convention of churches, or a tax-exempt organization as described above.

This provision applies to years beginning before, on, or after the date of enactment (December 20, 2019).

Nondiscrimination rules for closed defined benefit plans

To prevent unnecessary plan freezes in defined benefit plans, closed plans that meet certain requirements may be aggregated with one or more defined contribution plan and tested on a benefits basis. Similar relief would apply to:

- Freezing a defined benefit plan and providing make-up contributions and/or benefits, rights, or features under a defined contribution plan for existing employees; and
- Closing or freezing a defined benefit plan that would otherwise trigger a violation of the minimum participation rules.

These changes are generally effective on the date of enactment, but plan sponsors may elect to apply the changes to plan years beginning after December 31, 2013.

Increased penalties for failure to file retirement plan returns

The penalty for failure to file Form 5500 is increased from $25 to $250 for each day during which the failure continues. The maximum penalty is increased from $15,000 to $150,000. The penalty for failure to file a registration statement regarding separated, deferred vested participants (Form 8955-SSA) is increased from $1 to $10 per participant to whom the failure applies. The maximum penalty is increased from $5,000 to $50,000. The penalty for a failure to file a required notification of changes in a plan's registration information also increased from $1 to $10 for each day the failure continues, with the maximum penalty increasing from $1,000 to $10,000. The penalty for failure to provide a required withholding notice increases from $10 to $100 for each failure, and the maximum penalty increases from $5,000 to $50,000.

These changes apply to returns, statements and notifications that are required to be filed, and notices required to be provided, after December 31, 2019.

In-service distributions for pension plans and governmental 457(b) plans

The minimum age for allowable in-service distributions of 62 for pensions plans, such as defined benefit plans and money purchase pension plans, and 70½ for governmental 457(b) plans is reduced to age 59½. This change applies to plan years beginning after December 31, 2019.

Disaster relief

The Act provides tax relief for retirement plan distributions taken by individuals who have been affected by disasters that were declared major disasters by the President between the period beginning on January 1, 2018 and February 18, 2020. This relief does not cover disasters that begin after December 20, 2019, or the California wildfire disaster areas that were eligible for relief under the Bipartisan Budget Act of 2018.

The Act permits individuals who were directly affected by a disaster to take "qualified disaster distributions" from their retirement plans. An individual's total qualified disaster distributions for each qualified disaster cannot exceed $100,000. This limit applies to all qualified disaster distributions from plans maintained by the employer (and any member of any controlled group which includes the employer).

The following special tax rules apply to qualified disaster distributions:

- They are exempt from the 10% federal income tax penalty on early distributions.
- If made from a qualified plan, 403(b) plan, or governmental section 457 plan, they are not eligible for rollover and therefore, are not subject to mandatory 20% federal tax withholding.
- They are included in the individual's gross income ratably over a three-taxable year period, beginning with the year in which the distribution occurred, unless the individual elects otherwise.
- They may be repaid within three years to an "eligible retirement plan" (i.e., an IRA, a qualified plan, a governmental section 457 plan, or a 403(b) arrangement) in which the individual is participating, provided the plan is eligible to receive a rollover contribution. The repayment does not have to be made to the same plan or IRA from which the distribution was made.

Under the Act, plans may allow individuals who are eligible to take qualified disaster distributions to take larger loans from qualified plans, 403(b) plans, and governmental section 457 plans. The maximum loan amount available to these individuals for loans taken on or after December 20, 2019, and before June 17, 2020 (when added to the outstanding balance of all other loans from the plan), cannot exceed the lesser of:

- $100,000 minus the difference between
  - The highest outstanding balance of loans from the plan during the last 12 consecutive month period, and
  - The outstanding balance of loans from the plan on the date the loan is made; or

- The greater of:
    - o 100% of the vested account balance, or
    - o $10,000.

In addition, an individual with an outstanding plan loan on or after the qualified beginning date may delay for one year any loan repayments due after the beginning of the incident period and ending 180 days after the last day of the incident period. This delay will not cause the loan to become a taxable deemed distribution. After the one-year period ends, the loan must be reamortized to adjust payments for the new due date and accrued interest. The one-year postponement period will be ignored with respect to the term of the loan.

The Act also amends the Internal Revenue Code by adding an automatic 60-day extension for all federally declared disasters that are declared after enactment, December 20, 2019. This extension would apply to:
- The deadline for making contributions to qualified plans, 403(b) plans and IRAs;
- The deadline for distributing excess IRA contributions and recharacterizing IRA contributions; and
- The deadline for completing rollovers.

It is not clear whether this extension would apply broadly to other qualified plans deadlines, such as the Form 5500 filing deadline or the loan repayment deadline for disasters after February 18, 2020.

Additional provisions

The Act also includes the following additional provisions pertaining to retirement plans:
- *Plan adoption deadline.* The Act extends the period of time an employer has to adopt a plan to the due date for the tax return for a taxable year. The new deadline applies to plans adopted for taxable years beginning after December 31, 2019.
- *Tax credits for small plans.* For employers with up to 100 employees, the Act increases the cap on the annual tax credit from $500 to $500 or the lesser of $5,000 or $250 multiplied by the number of non-highly compensated employees eligible to participate in the plan. For small plans, the Act also provides a credit of $500 per year for up to three years for adding automatic enrollment provisions to the plan. These changes apply to taxable years beginning after December 31, 2019.
- *Credit card loans.* Effective immediately, credit card loans are no longer permitted.
- *Special rules for minimum funding standards for community newspaper plans.* Sponsors of community newspaper plans under which no participant's benefit increased after 2017 receive special funding relief. Effective retroactively to plan years ending after December 31, 2017.
- *PBGC premiums for cooperative and small employer charity (CSEC) plans.* PBGC premiums for CSEC plans are reduced. For plan years beginning after December 31, 2018, the flat-rate premiums are reduced to $19 per participant and the variable-rate premiums are reduced to $9 per $1,000 of unfunded vested benefits.
- *Foster care difficulty of care payments.* For purposes of the defined contribution limitation, the participant's compensation is increased by any difficulty of care payments excluded from income. Difficulty of care payments are provided to foster care providers as additional compensation because the individual has a physical, mental, or emotional handicap. Any contributions of difficulty of care payments made to the plan are considered after-tax contributions. This provision applies to plan years beginning after December 31, 2015.
- *Repeal of Tax Cuts and Jobs Act (TCJA) requirement for unrelated business taxable income (UBTI).* Repeals the requirement added by the TCJA for tax-exempt organizations to increase UBTI by expenses related to qualified transportation fringe benefits. The repeal of the provision is retroactive to the 2017 enactment of the TCJA.

Provisions effective for plan years after December 31, 2020 or later

Pooled employer plans

A multiple employer plan (MEP), a plan to which more than one employer contributes, may provide participating employers a way to lower the cost associated with administering a plan. Under the Act, unrelated employers may participate in a pooled employer plan (PEP), that would be treated as a single plan for ERISA purposes. The Act also generally eliminates the “one bad apple” rule, under which a violation of the plan qualification rules by one employer in a defined contribution MEP would disqualify the entire MEP.

ERISA-covered MEPs, including PEPs, will be required to report on the Form 5500 a list of employers in the plan and a good faith estimate of the percentage of total contributions made by such employers during the plan year and the aggregate account balances attributable to each employer in the plan and with respect to a PEP, the identifying information for the “pooled plan provider,” which is the named fiduciary and plan administrator of a PEP. The Department of Labor (DOL) is authorized to provide simplified reporting for MEPs that cover fewer than 1,000 participants, but only if no single employer has 100 or more participants covered by the plan.

This provision is effective for plan years beginning after December 31, 2020.

Coverage of long-term part-time employees

Except for collectively bargained plans, the Act requires employers sponsoring a 401(k) plan to cover employees who complete at least 500 hours of service for three consecutive 12-month periods (and have reached age 21). For participants who are eligible under this new rule, the plan sponsor is not required to provide any matching or nonelective contributions that would otherwise be required under the plan. The sponsor may also elect to exclude such employees from testing under the nondiscrimination and coverage rules. Generally, this provision is effective for plan years beginning after December 31, 2020.

Lifetime income disclosure

Under the Act, defined contribution participant benefit statements are required to include a lifetime income disclosure at least annually. The disclosure is required to set forth the monthly lifetime income stream equivalent of the participant’s total account balance in the form of a qualified joint and survivor annuity and a single life annuity based on assumptions to be provided by the DOL within a year of enactment. This provision is effective for participant benefit statements furnished more than one year after the DOL issues guidance.

Plan amendments

The Act includes a remedial amendment period, giving plan sponsors time before they need to amend their plan for the new law. For non-collectively bargained plans, the plan amendment deadline is the last day of the first plan year beginning on or after January 1, 2022. For governmental and collectively bargained plans, the plan amendment deadline is the last day of the first plan year beginning on or after January 1, 2024.

Effective dates and next steps

To ensure inclusion of the SECURE Act provisions in the year-end spending bill, Congress chose not to modify the original effective dates of those provisions. Due to issues caused by the immediate effective dates of some of the provisions of the Act, industry groups have requested immediate guidance and relief by the Department of Treasury and IRS. Prudential Retirement will keep you informed of any such relief issued by the IRS.

Additionally, there are a number of provisions that require additional clarification and guidance. Prudential Retirement will continue to monitor the federal agencies’ guidance regarding these new rules. We will keep you informed as guidance is provided.

Pension Analyst by Prudential Retirement
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